No. 16,348

In the United States Court of Appeals for the Ninth Circuit

UNITED STATES OF AMERICA, APPELLANT,

v.

IRIVING I. BASS, Trustee in Bankruptcy of the Estate of Leland Cameron, Bankrupt, APPELLEE

ON APPEAL FROM THE ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLANT

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INDEX

CITATIONS

Cases:

Cases—Continued

Cases—Continued

Cases—Continued

Statutes:

Statutes—Continued

Miscellaneous:

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BRIEF FOR THE APPELLANT

OPINIONS BELOW

The memorandum opinion of the referee (R. 8-9) and the findings of fact, conclusions of law and order of the referee (R. 11-14) are not officially reported. The opinion of the District Court (R. 19-41) is reported at 166 F. Supp. 400.

JURISDICTION

This appeal involves a lien claim by the United States for unpaid federal taxes and interest against the property of Leland Cameron, d/b/a Allied Aircraft Company, filed with the trustee in bankruptcy. (R. 3-5.)

On August 8, 1958, the referee in bankruptcy allowed the secured claim of the United States in the amount of $19,763.31, representing $17,015.58 of unpaid taxes, $294.09 of interest accruing on such unpaid taxes prior to the petition in bankruptcy and $2,453.64 of interest accruing on such unpaid taxes after filing of the petition in bankruptcy to the date of payment. (R. 11-14.) The trustee on August 15, 1958, filed a petition to review the order of the referee insofar as the referee allowed post-petition interest on the lien portion of the claim of the United States. (R. 14-15.) On October 6, 1958, the District Court entered an order reversing the order of the referee to the extent that the referee allowed post-bankruptcy interest. (R. 45.) The proceeding is brought to this Court by notice of appeal filed November 12, 1958. (R. 46.) The amount involved is more than $500. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1291, and Section 24 of the Bankruptcy Act, as amended.

QUESTION PRESENTED

Whether the United States is entitled to post-bankruptcy interest on unpaid taxes where its claims for taxes and interest have been secured by a lien which arose and was perfected prior to the petition in bankruptcy.

STATUTES INVOLVED

The relevant provisions of the Bankruptcy Act, as amended, and the Internal Revenue Code of 1954 are set forth in Appendix, *infra*.

STATEMENT

Upon the trustee's objections to the claims of the United States, after hearing, the referee ruled upon

the allowance of certain secured claims of the United States for post-bankruptcy interest. The relevant facts were stipulated by the parties (R. 9-11) and, as stipulated, were found by the referee (R. 12). The relevant undisputed facts may be stated as follows:

On November 14, 1955, a petition in bankruptcy was filed against Leland Cameron, also known as L. H. Cameron, doing business as Allied Aircraft Company. (R. 12, 19.) Previously, on August 31, 1955, the District Director of Internal Revenue had assessed unpaid withholding and F.I.C.A. taxes against the taxpayer for the second quarter of 1955 in the amount of $17,015.58. (R. 3, 9-10, 12, 19.) Notice of the assessment with demand for payment was made on September 8, 1955. No payment was made at the time. (R. 10, 12.) A lien for the assessment was perfected prior to the filing of the petition in bankruptcy. (R. 10, 12, 19-20, 43.)

The District Director filed a claim against the bankrupt estate on January 26, 1956, for federal taxes owing by the bankrupt. This claim included a claim for $17,015.58 of unpaid withholding and F.I.C.A. taxes supported by a tax lien which arose and was perfected prior to bankruptcy and for $24,381.63 of withholding, F.I.C.A. and unemployment taxes unsupported by any lien. (R. 3-5, 43.) The trustee paid to the District Director between March 20, 1957, and July 9, 1958, the entire principal amount owing on the tax lien and on the tax claim not secured by any lien and further paid $294.39 of interest accruing upon the tax lien and interest accruing upon the unsecured tax claim to the date of bankruptcy, November 14, 1955. (R. 3-4, 10, 12, 19, 43.) The claim of the United States also included post-bank-

ruptcy interest accruing upon its tax lien from the date of bankruptcy to the date of payment of its lien. However, no claim was made by the United States for post-bankruptcy interest on its tax claim not secured by a lien. (R. 3-4, 12, 43-44.)

The validity and principal amount of the lien of the United States perfected prior to bankruptcy was not disputed by the trustee. The trustee objected to the payment of the interest accrued on the tax lien after the date of the filing of the petition in bankruptcy. (R 7-8, 9-10, 20, 43-44.) After hearing, on notice, the referee on August 8, 1958, concluded that a lien in favor of the United States in the amount of $17,015.58 arose at the time the assessment was made on August 31, 1955, and became a lien upon all property and rights to property, whether real or personal, belonging to the bankrupt, Leland Cameron; that this lien is valid against the trustee; and that interest accrued to the date of payment on a secured claim such as a tax lien and should be allowed as part of the lien claim of the United States. The referee then ordered that the claim of the United States for interest on the taxes which became liens prior to the date on which the bankrupt filed his petition be allowed, and that the amount of $2,453.64, remaining due, owing and unpaid be paid by the trustee to the United States. (R. 13.)

The trustee petitioned the District Court for review of the referee's order. (R. 14-15.) The District Court reversed the order of the referee to the extent that the referee allowed post-bankruptcy interest in the amount of $2,453.64 upon the tax lien portion of the claim of the United States and further ordered that the proceedings be remanded to the referee with directions to

disallow the claim of the United States to the extent that the claim includes post-bankruptcy interests in the amount of $2,453.64 upon the tax lien portion of such claim. (R. 45.)

STATEMENT OF POINT TO BE URGED

The District Court erred in reversing the order of the referee in bankruptcy and in holding that the United States is not entitled to post-bankruptcy interest upon its tax claim secured by a lien existing prior to the filing of the petition in bankruptcy.

SUMMARY OF ARGUMENT

The general principles of the law of commercial transactions provide that a debtor should pay interest on his obligation to the date of payment of the principal amount owing. However, in bankruptcy there has been an exception to these general principles so as to suspend the payment of post-petition interest. This exception, in turn, has been qualified by three situations where post-petition interest has been allowed to certain creditors namely, where the bankrupt proves to be solvent, and in the case of secured claims, where the security produces income during the bankruptcy administration and where the value of the security is more than sufficient to pay the principal amount of the secured claim. In the present case the United States contends that by virtue of a pre-existing perfected tax lien it is a secured creditor, with the same right as other secured creditors to post-petition interest where the amount of the security is sufficient to satisfy the claim for interest in addition to principal.

The Government's tax lien under the taxing statutes, here the Internal Revenue Code of 1954, is

a fixed charge which is imposed upon and attaches to property and rights to property of the debtor. Under the taxing statutes if any amount of tax imposed is not paid when due interest is imposed until the amount of the tax owing is paid. Such interest on the unpaid tax obligation is treated as part of the tax and is assessed, collected and paid in the same manner as the tax. Such interest is also included as a part of the tax lien. In the present case at the time the petition in bankruptcy was filed the taxpayer's obligation to pay interest was secured by a perfected federal tax lien on all property and rights to property of the taxpayer, which lien was valid against the trustees in bankruptcy.

The Bankruptcy Act, as amended, accords different treatment to secured and unsecured claims. A tax lien valid against the trustee at the time of bankruptcy is not invalidated or discharged by an adjudication of bankruptcy. On the contrary, its validity is recognized and protected by Section 67b of the Bankruptcy Act. Similarly, with one exception set forth in Section 67c postponing the payment of certain statutory liens, including tax liens, on personal property not reduced to possession to two other classes of creditors, payment of the tax lien is not governed by the provisions of the Bankruptcy Act (such as Section 64) which govern payment to unsecured creditors. Instead, payment of the tax lien is governed by the same common law principles which apply to other secured creditors, i.e., according to the time the lien becomes perfected. There is no provision in the Bankruptcy Act which permits a tax lien to be disregarded or treated as a mere unsecured priority claim, or to discharge part of the amount owing under the lien. Further, with the

one exception of Section 67c, there is no provision in the Bankruptcy Act which distinguishes between the treatment (including the payment) of federal tax liens and other liens, such as consensual liens. Thus, the District Court erred in holding that the tax lien of the United States is not entitled to payment of post-bankruptcy interest from the assets of the bankrupt estate.

ARGUMENT

The United States Is Entitled to Post-Bankruptcy Interest on Its Tax Claims Secured by Liens Filed Prior to Bankruptcy

A. *Introduction*

The general principles of the law of commercial transactions have long provided that a debtor should pay interest on his obligations to the date of payment. However, an exception to this general principle was invoked very early as a fundamental principle of the English bankruptcy system, that the payment of interest is suspended where a debtor is so hopelessly insolvent that he is unable to pay even the principal and interest accruing on an unsecured claim prior to bankruptcy. This exception suspending the payment of interest in turn was held not to apply under certain conditions, namely, where the estate proved to be solvent (*Bromley v. Goodere,* [1734] 1 Atk. 75, 26 Eng. Reports Full Reprint 49; *Ex Parte Mills,* [1793] 2 Ves. Jun. 295, 30 Eng. Reports Full Reprint 640), where income is derived from the security which can be applied to the payment of post-bankruptcy interest (*Ex Parte Penfold,* [1851] 4 De G. & Sm. 282, 64 Eng. Reports Full Reprint 834) and where the security is sufficient to satisfy both the principal and interest on the secured claim (*In re London, Windsor and Greenwich Hotels Co. (Quarter-*

maine's Claim), [1882] 1 Ch. 639, 61 Law Journal Reports (N.S.) (Part I) 233).

The above principles of the English bankruptcy system have been followed by the courts of this country. *Sexton* v. *Dreyfus*, 219 U.S. 339, 344; *New York* v. *Saper*, 336 U.S. 328, 330. Thus we find in the American decisions the general statement that interest stops as of the date of the filing of the petition in bankruptcy. This general rule rested upon the theory that the affairs of the bankrupt are supposed to be wound up as of the date of bankruptcy, that the delay in payment of interest is not caused by an act of the debtor but by an act of the law for the mutual benefit of creditors, and that it would be inequitable to permit the payment of interest to certain creditors which would increase the proportion of the assets to which these creditors are entitled at the expense of the other creditors while the estate is in the process of administration. *Sexton* v. *Dreyfus, supra; New York* v. *Saper, supra; Vanston Committee* v. *Green*, 329 U.S. 156, 163-164; 3 Collier on Bankruptcy (14th ed.), Section 63.16; 6 Remington on Bankruptcy (Sixth ed.), Sections 726, 2827 and 2869.

However, the American decisions have also followed the English rule of law and have allowed post-bankruptcy interest where the alleged bankrupt proves to be solvent, where the security produces income during the bankruptcy administration and where the value of the security is more than sufficient to pay the principal of the secured claim. In the last instance, payment of post-petition interest to a secured creditor has been allowed on the grounds that the collateral is as much security for the payment of interest on the obli-

gation as it is for the payment of the principal of the obligation, and that it is not inequitable to pay interest to a secured creditor where there is a surplus of security available before making such surplus available to satisfy the claims of junior creditors. Recently, this Court in *Palo Alto Mutual Savings and Loan Ass'n* v. *Williams,* 245 F. 2d 77, and in *Jefferson Standard Life Ins. Co.* v. *United States,* 247 F. 2d 777, 780, overruled an earlier decision to the contrary and held that a secured creditor is entitled to post-bankruptcy interest. See also *Coder* v. *Arts,* 213 U.S. 223, 245; *Castaner* v. *Mora,* 234 F. 2d 710, 712 (C.A. 1st); *Kagan* v. *Industrial Washing Machine Corp.,* 182 F. 2d 139, 146 (C.A. 1st); *Eddy* v. *Prudence Bonds Corp.,* 165 F. 2d 157, 160 (C.A. 2d); *Littleton* v. *Kincaid,* 179 F. 2d 848 (C.A. 4th), certiorari denied, 340 U.S. 809; *Oppenheimer* v. *Oldham,* 178 F. 2d 386, 389 (C.A. 5th); *United States* v. *Paddock,* 187 F. 2d 271, 276 (C.A. 5th); *In re Macomb Trailer Coach,* 200 F. 2d 611, 613 (C.A. 6th), certiorari denied, *sub nom. McInnis, Trustee* v. *Weeks,* 345 U.S. 958; *In re Inland Gas Corp.,* 241 F. 2d 374, 379 (C.A. 6th); *In re Chicago R. I. & P. Ry.,* 155 F. 2d 889, 892 (C.A. 7th), reversed on other grounds, *sub nom. Fleming* v. *Traphagen,* 329 U.S. 686.[1]

Accordingly, we submit that allowance of post-bankruptcy interest to a secured creditor, where the

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[1] In view of this exception which recognizes and allows post-petition interest in bankruptcy in the case of secured claims, the discussion in *Sword Line* v. *Industrial Commissioner of State of N.Y.,* 212 F. 2d 865 (C.A. 2d), certiorari denied, 348 U.S. 830, and *National Foundry Co. of N.Y.* v. *Director,* 229 F. 2d 149 (C.A. 2d), denying the existence of interest on non-lien claims clearly has no relevancy here. Cf. *Salsbury Motors* v. *United States,* 210 F. 2d 171, 174 (C.A. 9th), certiorari denied, 347 U.S. 953.

amount of the security is sufficient, is firmly entrenched as a fundamental principle of law by the bankruptcy courts of England and this country. It is the position of the government in the present case that where it has a pre-existing tax lien it should be treated as a secured creditor, with at least the same rights as other secured creditors to post-petition interest, i.e., if other secured creditors are entitled to post-bankruptcy interest under certain circumstances, the Government should also be entitled to post-bankruptcy interest under the same circumstances.

We also submit that *New York* v. *Saper, supra,* is not controlling here. In *Saper* the Government's tax claims were not secured by any lien. In that case the Government sought to obtain post-bankruptcy interest solely upon the ground that its tax claims as such were entitled to interest to the date of payment. The Supreme Court denied the Government's contention on the ground that by the amendments made by the Act of June 22, 1938, the so-called Chandler Act, to Sections 57 and 64 of the Bankruptcy Act Congress intended to treat tax claims for this purpose similarly to priority claims and did not contemplate any exception in favor of tax claims from the general rule against allowing post-bankruptcy interest.

The *Saper* decision does not hold that by the Chandler Act Congress intended to remove the long-established distinction between unsecured (albeit priority) claims and secured claims, or that Congress intended to remove a tax lein from the status of a secured claim.[2] That

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[2] For the same reasons, among others, *United States* v. *General Engineering & Mfg. Co.*, 188 F. 2d 80 (C.A. 8th), affirmed *per curiam*, 342 U.S. 912; *United States* v. *Edens*, 189 F. 2d 876 (C.A. 4th), affirmed *per curiam*, 342 U.S. 912; *Pavone Textile Corp.* v.

this is so is expressed in *Oppenheimer* v. *Oldham, supra,* p. 389, as follows:

> The above holding is not in conflict with the decision of the Supreme Court in *City of New York* v. *Saper, Trustee in Bankruptcy,* 336 U. S. 328, 69 S. Ct. 554, 559. That decision dealt with the propriety of interest on tax claims after bankruptcy, and turns mainly on changes in the statute law wrought principally by the Chandler Act, 11 U.S.C.A. § 1 et seq. The Court points out before the enactment of that act the lower courts had been allowing interest on tax claims until payment, "either as a matter of practical convenience or because Sec. 46, sub. a gave those claims absolute priority and dispensed with proof." The law formerly put tax liabilities in a sovereign class above the status of mere claims in bankruptcy. In fact the filing of a claim was unnecessary, but nevertheless taxes were payable as imperative obligations commanding absolute priority. The act of 1926 reinforced by the Chandler Act reversed that highly favored position of tax liabilities, which instead were shifted to the rank of simple claims in bankruptcy, and the Court concluded that the continued allowance of interest on tax claims after bankruptcy would be inconsistent with such changes made in the framework of the bankruptcy law.

Bloom, 302 N.Y. 206, 97 N.E. 2d 755, affirmed *per curiam, sub nom. United States* v. *Bloom*, 342 U.S. 912, which denied post-petition interest upon the authority of *New York* v. *Saper, supra,* for proceedings by way of arrangement in reorganization and for a general assignment, are not applicable here since these cases did not involve lien claims.

> Those considerations have no bearing on contractual debts presented as secured claims in bankruptcy. It has always been a fundamental principle of the bankruptcy law that the property rights and interests designated as liens and pledges, when valid in bankruptcy, shall not be impaired in the administration of a bankrupt estate. The Chandler Act manifests no intent to deviate from that principle. It is true that in the revision of Sec. 67, sub. d the Chandler Act did not retain the old language saying expressly that liens valid in bankruptcy shall "not be affected by anything herein", but that provision was simply declaratory of the obvious import reflected, and still reflected, frequently in the substantive terms of the law, and the omission of such redundancy is not significant.

See also *In re Macomb Coach, supra,* p. 613.

It is the postion of the United States in the present case that by virtue of having perfected its tax lien prior to the petition in bankruptcy the United States is a secured creditor and as such is entitled to post-petition interest on its liened tax claim where there is a sufficient amount available to satisfy its lien for the taxes and interest owing to the date of payment.[3] On the other hand, although the United States also was claiming $24,381.63 of additional taxes owing by the bankrupt for which it did not have any lien prior to bankruptcy, the United States recognized the distinction between

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[3] In the present case no question arises as to the sufficiency of the amount available in the bankrupt estate to satisfy both the principal amount of the tax lien and the $2,453.64 of post-petition interest.

an unsecured priority tax claim and a secured tax lien claim and did not claim post-bankruptcy interest on the unliened part of its tax claim. (R. 3-4, 43-44.) The District Court's disallowance of post-petition interest appears to be predicated upon the assumption that there is no relevant difference between an unsecured tax claim and a perfected tax lien and even if there were a tax lien does not have the same status as a consensual lien. We submit that there is no support for the District Court's position either in the Internal Revenue Code of 1954 or in the Bankruptcy Act. Instead, the 1954 Code which creates the tax lien and vests the lien with certain property rights and powers which are lacking in the case of an unliened tax claim, and the Bankruptcy Act which distinguishes between a secured and an unsecured claim, fully support the position of the United States in this case. Accordingly, we shall first examine the nature of the Government's tax lien under the taxing statute.

B. *Nature of the Government's lien for taxes and interest*

The distinctions between a non-liened tax claim and a tax lien are deeply rooted in the statutes.

The lien in favor of the United States for taxes arises under Section 6321 of the Internal Revenue Code of 1954 (Appendix, *infra*), which provides as follows:

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon

> all property and rights to property, whether real or personal, belonging to such person.

Under Section 6322 of the 1954 Code (Appendix, *infra*) a federal tax lien arises at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

Where the United States has a tax lien its rights are enlarged and have matured to a much greater extent than where the United States is merely asserting a non-liened tax claim. The lien is a fixed charge which is imposed upon and attaches to the property and rights to property of the debtor; it affects a transfer to the United States of part of the taxpayer's property. "After the lien provided by the statute attaches, the property has in a sense two owners, the taxpayer and, to the extent of the lien, the United States." *United States* v. *City of Greenville,* 118 F. 2d 963, 965 (C.A. 4th). The non-liened tax claim of the United States, on the other hand, does not become a fixed charge on the taxpayer's property subject to the bankruptcy proceeding, but is merely an assertion by the United States of an amount owing to it by the taxpayers—a chose in action. On the other hand where, as here, the United States possesses a perfected tax lien prior to bankruptcy, the taxpayer's assets subject to the lien, to the extent that they ever become subject to the jurisdiction of the bankruptcy court (see Part C, *infra*), come into bankruptcy encumbered by the lien of the United States.

The formalities surrounding the creation of the lien of the United States are greater than those involved

in the assertion of an unliened claim. The tax lien of the United States does not arise or become perfected (choate) until a formal assessment is made, notice and demand are served upon the taxpayer and the latter neglects or refuses to pay the liability. *Brust* v. *Sturr,* 237 F. 2d 135 (C.A. 2d). A formal assessment comes into existence when an assessment officer signs the assessment certificate which is part of the summary record of assessment. The summary record of assessment identifies the taxpayer, the character of the liability assessed, the taxable period and the amount of the assessment.

The character of the tax liens of the United States is well established. In *Glass City Bank* v. *United States,* 326 U.S. 265, the Supreme Court discussed the nature of these liens under the Internal Revenue Code of 1939 (which provisions are substantially the same as the correlative provisions of the 1954 Code), as follows (p. 267):

> By § 3670, 26 U.S.C., Congress impressed a lien upon "all property and rights to property, whether real or personal, belonging" to a tax delinquent. Stronger language could hardly have been selected to reveal a purpose to assure the collection of taxes. Not content with this language, however, Congress also provided that the lien should "continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time." 26 U.S.C., § 3671. These two sections read together indicate that a continuing lien covers property or rights to property in the delinquent's hands at any time prior to expiration. This is confirmed

> by § 3678, which provides that "whether distraint proceedings have been commenced or not," action to enforce the lien may be instituted against "any property and rights to property, whether real or personal, or to subject any such property and rights to property *owned by the delinquent,* or in which he *has* any right, title, or interest, to the payment of such tax."

Further, in *United States* v. *New Britain,* 347 U.S. 81, the Court described these liens as follows (p. 84):

> The federal tax liens are general and, in the sense above indicated, perfected. But the fact that one group of liens is specific and the other general in and of itself is of no significance in these cases involving statutory liens on real estate only. *United States* v. *City of Greenville,* 118 F. 2d 963, 964. A mortgage is a specific lien, yet "[a] statutory lien is as binding as a mortgage, and has the same capacity to hold the land so long as the statute preserves it in force." *Rankin* v. *Scott,* 12 Wheat. 177, 179.

The same principles apply with equal force to federal tax liens on personal property as to liens on real property. See *United States* v. *Ball Construction Co.,* 355 U.S. 587, rehearing denied, 356 U.S. 934, reversing *per curiam,* 239 F. 2d 384 (C.A. 5th); *United States* v. *White Bear Brewing Co.,* 350 U.S. 1010, reversing *per curiam,* 227 F. 2d 359 (C.A. 7th); *United States* v. *Colotta,* 350 U.S. 808, reversing *per curiam,* 79 S. 2d 474 (Miss.); *United States* v. *Scovil,* 348 U.S. 218; *United States* v. *Liverpool & London Ins. Co.,* 348 U.S. 215;

United States v. *Acri,* 348 U.S. 211; *United States* v. *Security Tr. & Sav. Bk.,* 340 U.S. 47.

It is clear that the tax lien of the United States includes an obligation for interest.[4] Section 6601(a) and (c) of the 1954 Code (26 U.S.C. 1952 ed., Supp. II, Sec. 6601) provides that if any amount of tax is not paid interest on such amount at the rate of six percent per annum shall be paid for the period from the last date prescribed for payment to the date paid. Paragraph (f) of Section 6601 provides that interest prescribed under this section shall be assessed, collected and paid in the same manner as the tax. *Big Diamond Mills Co.* v. *United States,* 51 F. 2d 721 (C.A. 8th); *Colorado Milling & Elevator Co.* v. *Howbert,* 57 F. 2d 769 (C.A. 10th). Section 6201(a) of the 1954 Code (26 U.S.C. 1952 ed., Supp. II, Sec. 6201) in turn includes interest as part of the amount of the tax which may be assessed, and Section 6321 of the 1954 Code, *supra,* provides that the Government's tax lien shall include any interest that may accrue in addition to the tax remaining unpaid. Thus, it is clear that interest accruing on unpaid taxes is included in and as an integral part of the tax lien of the United States to the same extent as the unpaid principal of the assessed tax liability.

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[4] In the present case the validity of the lien of the United States for interest was never questioned by the trustee or referee. Payment of interest up to the date of the filing of the petition in bankruptcy is not contested by the trustee. (R. 7-8, 8-9, 10, 12, 14-15, 43). On appeal the United States is contending that there was no basis for the District Court to disallow the balance of the interest due under the lien. Further, there is no dispute but that the amount of post-petition interest claimed is correct, if it is allowed. (R. 8-9, 10, 12, 17, 20, 44.)

In the present case the $2,453.64 of accrued interest here in issue was included in the assessment by reasons of the above statutory provisions. There is no dispute, as the District Court found (R. 20, 43), as to the fact that the lien of the United States was fully perfected prior to the filing of the petition in bankruptcy on November 14, 1955, so that the trustee in bankruptcy took possession of the taxpayer's property subject to the tax lien. See Section 67b of the Bankruptcy Act, as amended (Appendix, *infra*).

Where the United State has a valid perfected lien it may be enforced against a taxpayer's property either by suit under Section 7403 of the 1954 Code (26 U.S.C. 1952 ed., Supp. II, Sec. 7403) or by levy and distraint under Section 6331 of the 1954 Code (26 U.S.C. 1952 ed., Supp. II, Sec. 6331) after notice of the assessment has been given to the taxpayer, demand has been made for payment and the taxpayer has neglected or refused to pay.[5] *Detroit Bank* v. *United States,* 317 U.S. 329, 335; *Macatee, Inc.* v. *United States,* 214 F. 2d 717 (C.A. 5th).

Where the United States seeks to enforce its lien against property of the taxpayer its lien is considered to have become perfected as of the time the assessment is made. With respect to the relative priorities of secured creditors, including the United States, to the property of either a solvent or bankrupt taxpayer, the tax lien of the United States is on a par with other secured claims. The priorities of competing liens are governed by the time they become perfected. Ordi-

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[5] See *Commissioner* v. *Stern,* 357 U.S. 39, and *United States* v. *Bess,* 357 U.S. 51, where the Supreme Court emphasizes certain distinctions between proceedings in liened and non-liened tax cases.

narily the lien first in time is first in right, based on the common law principle that "a prior lien gives a prior claim, which is entitled to satisfaction out of the subject it binds." *Rankin* v. *Scott,* 12 Wheat. 177, 179; *Michigan* v. *United States,* 317 U.S. 338; *United States* v. *New Britain, supra.* With respect to all classes of secured creditors, except those enumerated in Section 6323 of the 1954 Code (Appendix, *infra*), priority of the tax lien of the United States is determined as of the time the lien becomes perfected—i.e., when the assessment list is signed. With respect to the classes enumerated, i.e., mortgagees, pledgees, purchasers or judgment creditors, the priority of the Government's tax lien is determined as of the time its notice of lien is filed.[6]

We turn next in Part C of our brief, *infra,* to the provisions of the Bankruptcy Act, as amended, which distinguish between the payment of secured claims and of unsecured (including priority) claims.

C. *Status of liened claim under the Bankruptcy Act*

One of the fundamental principles of bankruptcy law has been the different status accorded to secured claims from unsecured claims. The distinctions between these claims have remained in existence ever

[6] No question arises in the present case as to the necessity for filing a notice of the tax lien. The record does not disclose that there were any creditors who were in the categories protected by Section 6323 and, as we have pointed out, *supra,* the District Court found that the tax lien was perfected prior to the filing of the petition in bankruptcy. (R. 20, 43.) In any event, as this Court has held, a trustee in bankruptcy does not come within any of the protected classes, and the United States is not required to file a notice of lien in order to preserve its status as a secured creditor with respect to the trustee. *United States* v. *England,* 226 F. 2d 205 (C.A. 9th).

since the early English bankruptcy law. The early English statutes were primarily concerned with protecting creditors against fraudulent debtors. Under the common law of those days the principal remedies of an unsecured creditor were those of attachment and execution. The common law favored the diligent creditor who made the first seizure. He was entitled to precedence to the full amount of his claim over creditors making later levies. This was found to work an injustice since, as commerce increased, situations frequently began to arise where a debtor had many creditors who had contributed to the common fund, instead of only a single creditor. Where there were many creditors all were considered to be entitled to share in what was left of the debtor's property. Accordingly, the early English bankruptcy acts provided for the seizure of the bankrupt's property by a common agent acting in behalf of the unsecured creditors and for a *pro rata* distribution among them of the proceeds of the bankrupt's goods seized. 1 Remington on Bankruptcy (Fourth ed.), pp. 4-21.

These acts, however, made no provision for the secured creditors. Apparently the latter were not considered as requiring the protection of the bankruptcy court since they already had a charge upon property belonging to the bankrupt. Thus, property subject to a security was not considered to be a part of the bankruptcy proceedings, and a secured creditor was left to his common law remedies to enfore his claims.[7] This concept largely has carried over into the bankruptcy

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[7] It should be noted that the early English acts did not contain any provisions to avoid a preferential payment of an honest debt. See 1 Remington on Bankruptcy, *supra*.

laws of this country and remains in effect to the present time.

The present Bankruptcy Act, as amended, carefully preserves the many distinctions between secured and unsecured claims. In the present case we are concerned chiefly with Sections 57, 60, 64, 67 and 70 of the Bankruptcy Act, as amended (11 U.S.C. 1952 ed., Secs. 93, 96, 104, 107 and 110). Section 70 deals with the title of the bankrupt's property which vests in the trustee; Section 57 deals with the proof and allowance of claims which an unsecured claimant must make and which a secured claimant may elect to make; Section 60 deals with preferred creditors; Section 64 deals with the payment of unsecured claims and specifically with the order of priority among certain classes of unsecured creditors; and Section 67 deals with liens and fraudulent transfers. As we shall demonstrate, *infra,* secured creditors are not required to be subject to the provisions of Sections 57 and 64 relating to the filing and proving of claims and to the payment of claims.

The trustee in bankruptcy takes possession of all property and rights to property of the bankrupt as of the date the bankruptcy proceeding commences. Under Section 70c, *supra,* the trustee is vested with the rights, remedies and powers of a creditor holding a lien on the bankrupt's property by legal or equitable proceedings. The trustee's title is subject to all valid liens, claims and equities. *Hewitt* v. *Berlin Machine Works,* 194 U.S. 296, 302-303; *Security Warehousing Co.* v. *Hand,* 206 U.S. 415, 423; *United States* v. *Sampsell,* 153 F. 2d 731, 735 (C.A. 9th); *In re Knox-Powell-Stockton Co.,* 100 F. 2d 979, 982 (C.A. 9th); *Commercial Credit Co.* v. *Davidson,* 112 F. 2d 54, 56 (C.A. 5th); *In re Van

Winkle, 49 F. Supp. 711, 713-714 (W.D. Ky.). The trustee also may assert all the defenses against secured creditors which were available to the bankrupt plus those provided in Sections 60 and 67d, *supra,* to set aside preferences, fraudulent conveyances and other voidable transfers.

In order to share in the distribution of the bankrupt estate an unsecured creditor (including one who has a priority under Section 64, *supra*), must file and prove his claim under Section 57, *supra.* Secured creditors are not required to file or prove their claims under Section 57. Instead, a secured creditor has a choice. In general, he may remain out of the bankruptcy proceedings and not file or prove his claim but rely solely upon his security. Or he may credit the bankrupt estate with the value of his security and prove his claim as a secured claim. He may also claim the value of his security and share in the general assets as to the unsecured balance. Finally, he may surrender his security and prove his claim as an unsecured creditor. The right of the secured creditor to collect from property of the bankrupt is set forth by the Supreme Court in *United States Bank* v. *Chase Bank,* 331 U.S. 28, 33, as follows:

> Under these provisions, there are several avenues of action open to a secured creditor of a bankrupt. See 3 Collier on Bankruptcy (14th ed.) pp. 149-157, 255-259. (1) He may disregard the bankruptcy proceeding, decline to file a claim and rely solely upon his security if that security is properly and solely in his possession. *In re Cherokee Public Service Co.,* 8 Cir., 94 F. 2d 536; *Ward* v. *First Nat. Bank,* 202 F. 609. (2) He must

file a secured claim, however, if the security is within the jurisdiction of the bankruptcy court and if he wishes to retain his secured status, inasmuch as that court has exclusive jurisdiction over the liquidation of security. *Isaacs* v. *Hobbs Tie & Timber Co.,* 282 U.S. 734. (3) He may surrender or waive his security and prove his entire claim as an unsecured one. *In re Medina Quarry Co.,* 179 F. 929; *Morrison* v. *Rieman,* 249 F. 97. (4) He may avail himself of his security and share in the general assets as to the unsecured balance. *Merrill* v. *National Bank of Jacksonville,* 173 U.S. 131; *Ex Parte City Bank,* 3 How. 292, 315.

Brans v. *City of Dallas, Texas,* 217 F. 2d 640 (C.A. 5th); *DeLaney* v. *City and County of Denver,* 185 F. 2d 246, 251 (C.A. 10th).

Upon commencement of a bankruptcy proceeding the bankruptcy court acquires exclusive jurisdiction over the bankrupt's property. The bankrupt estate has been held to include only the unencumbered assets of a bankrupt administered in bankruptcy as distinguished from assets dedicated to the payment of secured obligations. *In re Quaker City Uniform Co.,* 134 F. Supp. 596 (E.D. Pa.), reversed on other grounds, 238 F. 2d 155 (C.A. 3d), certiorari denied, 352 U.S. 1030. The bankruptcy court has jurisdiction, among other things, to exercise control over the administration of such unencumbered assets, allow or disallow claims, to distribute the bankrupt estate, etc. See Section 2 of the Bankruptcy Act, as amended (11 U.S.C. 1952 ed., Sec. 11). Thus, an unsecured creditor may collect on his claim only by submitting in full to the jurisdiction of the bankruptcy court.

A secured creditor, on the other hand, is not similarly restricted. Where the secured creditor elects to rely soley on his security and elects not to file a proof of claim, and the property subject to the lien is either real property or personal property in the possession of the secured creditor, the bankruptcy court does not obtain jurisdiction to determine the validity or correctness of the lien. Instead, in such instances the trustee must bring a plenary action for this purpose. But if the property subject to the lien comes into possession of the bankruptcy court, we agree that the bankruptcy court may determine the correctness and validity of the lien. However, in such instances Sections 2a(20) and 69c (11 U.S.C. 1952 ed., Secs. 11 and 109) of the Bankruptcy Act, as well as the report of the House Committee on the Judiciary in reporting the so-called Chandler Act, H. Rep. No. 1409, 75th Cong., 3d Sess., pp. 11-12, 19, distinguish between the extensive jurisdiction of the bankruptcy court over property of the bankrupt estate subject to unsecured claims and its more limited jurisdiction over property subject to secured claims. The jurisdiction of the bankruptcy court in the latter situation is primarily directed only to such matters as the preservation of a bankrupt's property subject to liens, the determination of the validity of such liens, their payment and the payment of the expenses of ancillary administration. Once the correctness and validity of the lien is established the bankruptcy court does not have jurisdiction to invalidate the lien or prevent its enforcement. *Arnold* v. *Phillips,* 117 F. 2d 497, 501 (C.A. 5th), certiorari denied, 313 U.S. 583; *Blue Ridge Lumber Products* v. *Nelson,* 213 F. 2d 451, 453 (C.A. 2d); *United States* v. *Heffron,* 158 F. 2d 657

(C.A. 9th). Thus, even if the security has passed into the possession of the trustee, and the lien claimant may assert his rights only in the bankruptcy court, nevertheless, even in such an instance, since Section 57 does not relate to secured claims (*Allen* v. *See,* 196 F. 2d 608, 610 (C.A. 10th)), a secured creditor is not required to file proof of a secured claim. Instead, he may file an intervening petition. *DeLaney* v. *City and County of Denver, supra,* pp. 251-252; *Brans* v. *City of Dallas, Texas, supra; Gotkin* v. *Korn,* 182 F. 2d 380, 382 (C.A. D. C.) *California State Board of Equal.* v. *Coast Radio Prod.,* 228 F. 2d 520, 525-526 (C.A. 9th); *United States* v. *England,* 226 F. 2d 205 (C.A. 9th).

Where at the commencement of a bankruptcy proceeding a secured creditor (including the United States with respect to a tax lien) has possession of real or personal property subject to a valid lien and elects not to file a proof of secured claim but seeks to satisfy his lien out of the security, his failure to file does not deprive him of his secured status. *Goggin* v. *California Labor Div.,* 336 U.S. 118; *United States* v. *Eiland,* 223 F. 2d 118 (C.A. 4th); *In re Brokol Manufacturing Co.,* 221 F. 2d 640 (C.A. 3d); *United States* v. *England, supra.* Further, the filing of a proof of secured claim where the property is in possession of the bankruptcy court will not deprive him of his secured status. *Reconstruction Finance Corp.* v. *Cohen,* 179 F. 2d 773, 776-777 (C.A. 10th).[8]

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[8] Where, as here, an assessment is made and a tax lien arises prior to the bankruptcy proceeding, the United States has the status of a secured creditor. On the other hand, where an assessment is not made until after the bankruptcy proceeding commences, the taxpayer's property is not subject to the tax lien as of the date of the filing of the petition in bankruptcy, and the trustee takes

If a secured creditor may satisfy his lien out of the property subject to the lien by reason of his possession, to pay him less than the full amount of his lien, as we contend the District Court erred in doing in the present case, would deprive the secured creditor of his rights under the lien based solely upon the happenstance as to whether the creditor or trustee first obtained possession of the property. We submit that no provision in the Bankruptcy Act subjects a secured creditor's substantial rights to a race between him and the trustee, and the cases cited above do not indicate that such a race is determinative of this question.

As we mentioned, *supra,* the Bankruptcy Act, as amended, also distinguishes between unsecured and secured creditors for purposes of payment. The payment to unsecured creditors is governed by Section 64, *supra,* which, among other things, establishes priorities among certain classes of unsecured creditors. On the other hand, with one exception discussed subsequently, neither Section 64 nor any other provision of the Bankruptcy Act governs the order of payment of secured creditors. Instead, payment to them is based upon the common law principle of first in time is first in right. *In re Knox-Powell-Stockton Co.,* 100 F. 2d 979, 982 (C.A. 9th); *DeLaney* v. *City and County of Denver,* 185 F. 2d 246, 240-250 (C.A. 10th); *City of Dallas* v. *Ryan,* 62 F. 2d 959 (C.A. 5th); *In re Quaker City Uniform Co., supra; In re Empire Granite Co.,* 42 F.

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possession of the property free and clear of the lien. In such an instance the United States would have status of only a priority unsecured creditor. See *Brust* v. *Sturr, supra.* Indeed, as already pointed out, this was the status of the United States here as to part of its tax claim, and as to that part no post-bankruptcy interest was claimed.

Supp. 450, 453 (M.D. Ga.); 6 Remington on Bankruptcy (Fifth ed., 1952), Sec. 2780; 3 Collier on Bankruptcy (14th ed., 1956), Sec. 64.02.

Prior to the enactment of the Chandler Act in 1938, it was generally accepted that a tax claim, secured or unsecured, was entitled to interest to the date of payment out of the assets of the bankrupt estate, if such assets were of sufficient value. This principle was based primarily on the reasoning stated in *In re Kallak,* 147 Fed. 276 (N. Dak.), which interpreted the Bankruptcy Act of 1898 to evidence a Congressional intent that the bankruptcy of a taxpayer should not remove the tax obligation from the general principle that a debtor should pay his legal obligation with interest to the date of payment. In this connection the court stated (p. 287):

> Section 64a, providing for the payment of the taxes in full in case there are sufficient funds in the estate available for that purpose, and section 17, of Act July 1, 1898, c. 541, 30 Stat. 550 [U.S. Comp. St. 1901, p. 3428] which provides that the discharge of the bankrupt shall in no way affect public taxes, clearly show that it was the intent of Congress that the public revenues of the state should be in no way prejudiced by the administration of the bankruptcy act.

At the time the Chandler Act was considered by Congress there were in reality four rather than three situations in which post-petition interest was payable. Two situations involved the preservation of a secured creditor's rights to interest; the third situation is the rare one where the estate in solvent. The fourth situa-

tion involved the preservation of tax claims so that public revenues would not be prejudiced by the insolvency of the taxpayer. Clearly then, there was no Congressional intent to preserve the estate of the bankrupt for the benefit of unsecured non-priority creditors to the detriment of the tax claim, including all statutory accruals thereto. The break in this generally accepted principle was construed by the Supreme Court in *New York* v. *Saper, supra,* to have been provided by Congress by the Chandler Act which (1) added subsection n to Section 57 of the Bankruptcy Act to provide that all claims of the United States and of any state or any subdivision thereof shall be proved and filed in the same manner as all other claims proved under the Act and which (2) made changes in Section 64 of the Bankruptcy Act with respect to the priority for payment of tax claims. The Supreme Court in *Saper* concluded that as a result of these changes tax claims against the bankrupt estate were now intended by Congress to be considered the same as other claims, and that this included the removal of the tax claim against the bankrupt estate from the general rule that a debtor pay his obligation with interest to the date of payment.

Agreeing that Congress by the Chandler Act removed the immunity of a tax claim from the operation of the bankruptcy rule against the payment of post-petition interest, it must then be determined whether it was the intent of Congress to place all taxes whether or not liened on a parity, or whether there was an intent to continue in effect the well-established distinction between a priority tax claim and a tax lien in a bankruptcy proceeding. We submit that an examination

of the Bankruptcy Act discloses that Congress was very much aware of the fact that a tax claim is unsecured in some instances and secured by a valid lien in others. This fact is evidenced by the changes made by the Chandler Act to Section 67 of the Bankruptcy Act.

By the Chandler Act Congress added paragraphs b and c to Section 67. (Appendix, *infra.*) Paragraph b preserves the validity of statutory liens, including those for taxes and debts owing to the United States or to any state or subdivision thereof, and provides for their perfection where such liens have not been perfected before bankruptcy, notwithstanding Section 60 of the Bankruptcy Act (11 U.S.C. 1952 ed., Sec. 96). By paragraph c of Section 67 the payment of statutory liens valid under paragraph b on personal property not accompanied by possession was postponed to the debts specified in Section 64a(1) and (2) of the Bankruptcy Act. (Appendix, *infra.*) It should be noted that in placing this restriction on the payment of certain tax liens Congress did not express any intent that the tax lien itself should be disregarded and the taxes paid as a priority claim. If such had been its intention we believe that Congress would not have included statutory liens on personal property not accompanied by possession among those whose validity was to be preserved, and Congress would not have used the word "postponed" with respect to their payment.

By Section 21(d) of the Act of July 7, 1952, c. 579, 66 Stat. 420, Congress further amended paragraph c of Section 67 providing in subparagraph c(2) for the removal of the lien status from, *inter alia,* statutory liens for debts of states or any subdivision thereof on personal property not reduced to possession. Again,

with respect to this 1952 amendment, if it had been the Congressional intention we submit that a statement, would have been included to show that the tax lien was only to be allowed as a priority claim, and Congress would not have retained the provision in subparagraph c(1) that the tax lien is valid against the trustee in the case of personal property not accompanied by possession while in subparagraph c(2) removing this lien status only with respect to statutory liens for debts of states or their subdivisions. As a matter of fact H. Rep. No. 2320, 82d Cong., 2d Sess., p. 13 (2 U.S.C. Cong. & Adm. News (1952) 1960, 1973), which accompanied the Act of July 7, 1952, c. 579, 66 Stat. 420, Section 21(d), commented with respect to the amendments to Section 67c which deprived certain state statutory liens (but not federal) of their validity against the trustee, as follows:

> The Chandler Act introduced section 67c as a new subdivision. In limiting statutory liens on personal property not accompanied by possession of such property, it met the situation presented by a growing tendency to express priorities in terms of liens and thus to defeat the scheme of priorities prescribed in section 64a of the Bankruptcy Act.

This language clearly shows a recognition by Congress of the distinction between priorities as governed by Section 64 (Appendix, *infra*) and the federal tax lien as governed by Section 67 and further shows an intention to preserve with certain specified exceptions the tax lien from the priorities provided in Section 64 for unsecured claims. See *In re Pennsylvania Central Brewing Co.,* 114 F. 2d 1010 (C.A. 3d), where the court

commented on the effect of these changes made by the Chandler Act as follows (p. 1012):

> The appellees refer to Section 64, sub. a (4) of the Act, 11 U.S.C.A. §104, sub. a (4), and contend that the provisions of this section operate to prohibit payment of the appellants' tax lien. This is not the case. The prohibition expressed in the section referred to applies where claims for taxes are made against the general assets of the estate, that is to say, assets not subject to liens or encumbrances.

Thus, it is clear that when Congress by amendments to Sections 57 and 64 waived the generally recognized immunity of the United States from the operation of the rule of bankruptcy regarding the payment of post-petition interest on unsecured claims, it did not intend to waive this immunity with respect to a tax obligation secured by a tax lien. The contention that it did apparently relies for support on *Saper*. However, as we have shown, *supra, Saper* involved non-liened claims and was decided on the basis of Congressional intent as expressed in the changes made by the addition of subsection n to Section 57 and by the provisions added to Section 64. Neither of these two sections relate to secured claims, statutory or otherwise.

If it is concluded that Sections 57 and 64 are applicable to secured tax lien claims then it would appear necessary to disregard the express language to the contrary contained in subsections b and c of Section 67 and, in the interest of consistency, assert that a tax lien must be proved in the same manner as an unsecured claim and that a tax lien has for all purposes only the

status of a priority claim under Section 64a(4). Such a construction is contrary to generally accepted bankruptcy principles that the requirements of filing and proving do not apply to secured creditors including tax lienors (*Brans* v. *City of Dallas, supra*), that the provisions of Section 64a(4) apply only to unsecured tax claims (*In re Pennsylvania Central Brewing Co., supra*), as well as to the fact that tax liens rank in priority with other secured liens (*United States* v. *New Britain, supra*). Moreover, any obliteration of the distinction between a tax lien and a priority claim is contrary to the comments made by the Supreme Court when it considered the more limited legislative intent of Congress in adding Section 67c to the Bankruptcy Act. In *Goggin* v. *California Labor Division,* 336 U.S. 118, 126-127, the Court made the following comments regarding Section 67c:

> While § 67c was added to the Bankruptcy Act by the Chandler Act in 1938, we find nothing in it or in its legislative history to suggest an abandonment of the underlying point of view as to the time as of which it speaks and the general purpose of Congress to continue to safeguard interests under liens perfected before bankruptcy. *City of Richmond* v. *Bird,* 249 U.S. 174; *In re Knox-Powell-Stockton Co.,* 100 F. 2d 979; *In re Van Winkle,* 49 F. Supp. 711. While § 64, as amended, somewhat readjusts priorities among unsecured claims, § 67 continues to recognize the validity of liens perfected before bankruptcy as against unsecured claims. * * * The background of § 67c suggests a conscious purpose to give a narrowly limited

> priority to administrative expenses and to certain wage claims, at least in instances disclosing accumulations of unpaid taxes the priority of which wage earners had no good reason to suspect, and which might absorb the entire estate of the bankrupt unless postponed by these provisions.

In addition, in a footnote on page 129 the Court cites as support Weinstein, The Bankruptcy Law of 1938 (1938), and quotes the following statement from it:

> While subd. a of sec. 64 provides for priority of payment of such costs and expenses, such payment is prior only to the other unsecured debts and does not affect or impair valid liens, whether statutory or otherwise.

To the same effect see *DeLaney* v. *City and County of Denver, supra,* p. 250; *United States* v. *England,* 226 F. 2d 205 (C.A. 9th); *California State Dept. of Employ.* v. *United States,* 210 F. 2d 242 (C.A. 9th); *Rochelle* v. *City of Dallas* (C.A. 5th), decided February 25, 1959 (C.C.H. Bankruptcy Law Reporter, par. 59, 430); *Phoenix Indemnity Co.* v. *Earle,* 218 F. 2d 645, 650 (C.A. 9th). Thus, it is clear that the amendments enacted by the Chandler Act and by the Act of July 7, 1952, *supra,* do not evidence any intention by Congress to assimilate secured tax claims even where imposed on personal property not accompanied by possession to unsecured tax claims for the purpose of removing tax liens from the rules applicable to the payment of interest on a secured debt, and further that the Supreme Court in its opinion in *Saper* did not place such an interpretation on these amendments.

D. *Applicability of lien provisions of the Bankruptcy Act to tax liens*

This is the second case in a Court of Appeals in which the issue has been raised as to whether the United States is entitled to post-petition interest where it has valid and perfected tax liens in existence prior to the filing of the petition in bankruptcy. The first case is *United States* v. *Harrington* which is currently pending in the Fourth Circuit (No. 7812) on appeal by the United States and as to which oral argument is scheduled for June 11, 1959. There have been several District Court decisions in point. *In re Parchem* (Minn.), decided August 12, 1958 (58-2 U.S.T.C., par. 9836), allowed post-petition interest to the United States under these circumstances.[9] Others have denied such interest. See *In re Industrial Machine & Supply Co.,* 112 F. Supp. 261 (W.D. Pa.); *In re Lykens Hosiery Mills,* 141 F. Supp. 895 (S.D. N.Y.); *In re Mighell,* 168 F. Supp. 811 (Kans.), currently on appeal by the United States to the Tenth Circuit.

The District Court below denied post-petition interest to the United States on its liened tax claims for the following reasons: (1) The Chandler Act amendments to Section 57 and 64a of the Bankruptcy Act, *supra,* relegated the tax liens of the United States to the status of unsecured priority claims. (R. 21-26.). (2) There is a difference between consensual and statutory liens, in that the former attach to specific property, whereas the tax liens of the United States are not a charge upon a

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[9] See *Marcalus Manufacturing Co.* v. *United States*, 169 F. Supp. 821 (C. Cls.), where the United States was held entitled to post-petition interest on a tax claim where the debtor proved to be solvent.

specific property, but are specific only for the purpose of determining priorities. (R. 26-27.) (3) for consensual liens the debtor authorizes the payment of any deficiency which might arise after the sale of the security, but he does not authorize such payment in the case of statutory liens. (R. 28-29.) (4) For consensual liens the debtor cannot question the validity or amount of the debt, whereas he can for tax liens which are only assertions of liability. (R. 29-31.) (5) Post-petition interest should not be allowed since it is in the nature of a penalty. (R. 32-33, 39-40.) (6) The aim of the Bankruptcy Act is to achieve equity of distribution among all creditors, and if the United States were to receive post-petition interest it would react to the detriment of other creditors. (R. 34-36, 41.) We submit that none of the above reasons are sufficient and valid.

1. Since we have discussed in detail in Part C of our brief, *supra,* our answer to the first ground for disallowing post-petition interest, i.e., that the Chandler Act amendements did not relegate the status of a tax lien to that of an unsecured priority claim, we shall not burden the Court with any further discussion of this point here, except to reiterate that in none of the cases relied upon by the District Court below, as *New York* v. *Saper, supra, United States* v. *General Engineering & Mfg. Co., supra,* and *National Foundry Co. of N.Y.* v. *Director, supra,* did the United States have any valid lien upon which it based its right to post-petition interest, and in those cases the courts did not discuss the status of a liened tax claim. Further, as we have pointed out, *supra,* other decisions have drawn a sharp distinction between the status of a tax lien and

an unliened priority tax claim, with the former being considered as a secured claim and not as a mere priority claim. See *United State* v. *England, supra, California State Dept. of Employ.* v. *United State, supra; Phoenix Indemnity Co.* v. *Earle, supra.* Cf. *United States* v. *City of Greenville, supra.*[10]

2. We submit that there is no basis for distinguishing between a tax lien and other liens, such as a mortgage lien, for purposes of payment of post-petition interest upon any of the grounds relied upon by the District Court below. For example, there is not any merit in the contention that tax liens are to be distinguished from contractual liens and discriminated against with respect to the payment of interest on the ground that the former are general and attach to all property of the taxpayer, whereas the latter are specific and become an encumbrance only on certain property. Indeed, much present day financing, as well as many of the security devices utilized today, are not of this kind. Many financing transactions contemplate that the collateral will include both the debtor's existing assets and

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[10] Similarly in *United States* v. *Edens, supra,* cited by the District court below (R. 37), the United States was not asserting its right to post-petition interest based upon any lien.

The District Court also appears to rely (R. 21-22, 36-37) upon statements in 3 Collier on Bankruptcy (14th ed., 1956), Sec. 63.26, and 2 Remington on Bankruptcy (Rev. ed., 1956), Secs. 800-805. However, an analysis of these statements in Collier and Remington reveals that these authorities were commenting upon changes made in the status of an unsecured tax claim by the Chandler Act and not upon the status of a secured tax claim. This is shown by the fact that both writers in other sections of their treatises refer to the necessity of distinguishing between a tax lien and a tax priority. See 3 Collier on Bankruptcy (14th ed., 1956), Sec. 64.403; 2 Remington on Bankruptcy (Rev. ed., 1956), Secs. 905, 908; and 4 Collier on Bankruptcy (14th ed., 1942), Sec. 67.24, which is quoted, in part, *infra.*

assets thereafter acquired by him in the operation of his business, such as accounts receivable, crops, intangibles, etc. Thus, the properties subject to the lien may change, the security may consist of after-acquired property, and the specific property to which the lien may attach at the time of default may not even have been in existence at the time the lien came into existence. Nevertheless, such after-acquired security interests are generally valid.[11] See Uniform Commercial Code (1958), Article 9; Coogan, Priorities Among Secured Creditors and the "Floating Lien", 72 Harv. L. Rev. 838 (1959). See also California Civil Code, Sections 2883, 2884, 2930, 3017, 3018 (11 West's Annotated California Codes (1954), Secs. 2883, 2884, 2930, 3017, 3018).

Also, as we have pointed out, *supra,* the Government's tax lien repeatedly has been held by the Supreme Court and other courts to be both general and specific (see *United States* v. *New Britain, supra; Glass City Bank* v. *United States,* 326 U.S. 265), and there is no provision in the Bankruptcy Act which limits the specificity of the tax lien only to the question of priority and excludes its applicability to the question of payment of interest. If the lien is valid under Section 67 of the Bankruptcy Act for purposes of payment of principal as against competing secured claimants it surely is as valid for purposes of payment of interest. If the lien is not paid according to its terms, i.e., with interest to the date of payment, this would constitute a partial invalidation of the lien, for which there does

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[11] However, any private encumbrance which arises within the time set forth in the Bankruptcy Act, may be struck down as a preference.

not appear to be any authority contained in the Bankruptcy Act.

As we have pointed out in Part C of our brief, *supra,* Section 67c provides only that the statutory lien for taxes on personal property not accompanied by possession is postponable to the payment of the debts specified in Section 64a(1) and (2). Yet there is nothing in the language of Section 67c to indicate that the specificity of the federal tax lien may be impaired with respect to its attachment to personal or real property of the debtor in the custody of the bankruptcy court. On the contrary, as we have shown in Part C of our brief, *supra,* Section 67c(1) merely shows a Congressional intent to postpone to a limited extent the priority of payment of the statutory lien. The only invalidating provision of Section 67c is contained in subsection (2) and is limited to certain statutory liens on personal property arising under state law.[12]

3. We submit that there is not any valid distinction between a contractual lien and a tax lien based upon the premise that for a contractual lien the debtor not only authorizes the satisfaction of the debt from the

[12] Indeed, *United States* v. *City of Greenville,* 118 F. 2d 963, 964, 965 (C.A. 4th), and *United States* v. *Reese,* 131 F. 2d 466 (C.A. 7th), which the court below cites (R. 27, 37-38), support the contention of the United States. Like mortgage liens the federal tax lien is not "to be deprived of validity because it attaches to a number of pieces of property instead of to a single piece, nor is it for that reason to be subordinated to a junior lien attaching to a single piece of property." Again "The Federal statutes create specific liens for taxes and as a corollary give a specific remedy for their removal and when such liens once attach, they may be lifted only as provided thereunder." The inference is that the tax lien, thus subsisting, extends to interest realizable out of the security as well as to principal. See *United States* v. *Bank of America* (C.A. 9th), decided February 2, 1959 (59-1 U.S.T.C., par. 9249), rehearing denied, May 1, 1959.

security but also agrees to the payment of any deficiency which might arise in the event the security is inadequate, whereas a taxpayer does not consent to the collection of any tax deficiency. It should also be noted that the tax lien, just as a mortgage, comes into existence bilaterally.[13] Anyhow, the validity of this distinction is questionable by reason of the California Code of Civil Procedure, Sections 580b and 580c (16 West's Annotated California Codes (1955), Secs. 580b, 580c), which limits a mortgagee, trustee or holder of notes secured by a purchase money mortgage to the value of the security and precludes a deficiency judgment.[14]

Further, the assumption that a distinction exists between a tax lien and a mortgage lien even for the limited purpose of disallowing post-proceeding interest is to disregard the Congressional mandate vesting the United States with a lien upon the property of a delinquent taxpayer, providing for the payment of interest

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[13] A taxpayer's mode of conduct under the laws, i.e., his failure to pay the full amount of his tax liability before assessment, demand and notice, renders him liable for any unpaid amounts after the value of the security has been exhausted.

[14] In this connection it should be noted that many statutes, including California, regulate by statute the creation and payment of liens covering a wide variety of matters, such as mechanics', laborers' and materialmen's liens, subcontractors' liens, assignments of accounts receivable, etc., including those on future interests. See California Civil Code, Sections 2883, 2884, 2930, 3017, 3018 (11 West's Annotated California Codes (1954), Secs. 2883, 2884, 2930, 3017, 3018).

Although some sections of the California Civil Code and California Code of Civil Procedure, such as Sections 580a and 726 of the latter (17 West's Annotated California Codes (1955), Secs. 580a, 726) permit some mortgagees to obtain a deficiency judgment on certain mortgages, as cited by the District Court below (R. 38, fn. 28), nevertheless these provisions are circumscribed by Sections 580b and 580c, as shown above.

upon the debt secured by the lien to the date of payment and limiting the manner in which the lien may be released or property discharged therefrom. See Section 6321 of the 1954 Code (Appendix, *infra*), Section 6601(a) of the 1954 code, supra, and Section 6325 of the 1954 Code (26 U.S.C. 1952 ed., Supp. II, Sec. 6325). Cf. *United States* v. *Bank of America* (C.A. 9th), decided February 2, 1959 (59-1 U.S.T.C., par. 9249), rehearing denied May 1, 1959. As we have shown in Part C of our brief, *supra,* there is no basis either in the Bankruptcy Act or in the Internal Revenue Code of 1954 to impute to Congress any intention to reduce a tax lien to the status of a prior unsecured claim. As recently as 1958, the House Committee on the Judiciary in H. Rep. No. 2535, 85th Cong., 2d Sess., p. 3, reported favorably on a bill to amend Sections 2a, 17a(1) and 64a(4) of the Bankruptcy Act, among other things, to effect the dischargeability of taxes in bankruptcy. The Committee Report expressed views which support the position of the United States in this context, as follows:

> While, under the bill, unsecured tax claims due and owing more than 3 years prior to bankruptcy would be dischargeable, there is no intention to place any time limit on otherwise valid tax liens. As with other secured claims like mortgages and conditional sales contracts, the purpose of the lien is to give the creditor a property interest which is indefeasible in bankruptcy. * * * The committee amendment discussed above, emphasizes this legislative intent.

While this bill (H. R. 12802) was not passed, the report of the Committee is entitled to weight. See *New York* v. *Saper, supra,* pp. 338-340.

4. Nor is there any basis for distinguishing between a contractual lien and a tax lien on the ground that for the contractual lien the genuineness of the instrument and the amount of the debt which it was given to secure is settled by the instrument itself, whereas in the case of a tax lien the validity and amount of the obligation may be in dispute. Before a tax lien arises under which the United States seeks to obtain post-petition interest it is necessary for the tax obligation to have been assessed before the commencement of the bankruptcy proceeding. This is so regardless of the nature of the tax involved. In the case of a tax lien supported by assessments of withholding and F.I.C.A. taxes which are involved in this case (R. 3, 9-10, 12, 16-17, 19), the assessments are based on liability disclosed by the debtor in a filed return or are based upon an examination of the bankrupt's records. Therefore, it is submitted that the frequency of litigation regarding the amount of tax liability secured by the lien is not substantially greater than, if in fact as great as, the litigation over the amounts owing under contractual liens. The reports disclose many decisions in the field of contracts, mortgages, mechanics' liens, etc., which involve the validity and amount of contractual liens. In fact, as the referee found (R. 8) there was no question here of the correctness of the amount of the assessed liabilities. Indeed, the District Court's argument on this facet of the case overreaches itself for it would lead to the conclusion that tax liens ought not to be treated as secured liens at all, even as to the principal amount due.[15]

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[15] Besides, the District Court's statements (R. 29-30), that a tax lien is merely an assertion by the United States that so much

In summation therfore, for the foregoing reasons, it is submitted that there is no valid distinction between a tax lien and a consensual lien which would justify

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tax remains unpaid and that the filing of the lien does not determine the amount due, for otherwise it would place a taxpayer at the mercy of a revenue agent who capriciously levied an assessment, minimizes certain safeguards inherent in the tax assessment procedures. For example, assessments of income, estate or gift taxes are based either upon the amount disclosed to be due and owing by the debtor on his income tax return or upon a finding by officials of the Internal Revenue Service that the actual liability of the debtor exceeds the amount shown on his return, i.e., that a deficiency exists. In the second instance an assessment of the deficiency cannot be made in the absence of an agreement by the taxpayer until ninety days after the taxpayer has been notified in writing as to the amount of and reasons for the deficiency, and he then has a right within the ninety day period to file a petition with the Tax Court for a re-determination of the deficiency. See Sections 6212 and 6213 of the 1954 Code (26 U.S.C. 1952 ed., Supp. II, Secs. 6212 and 6213). After the decision of the Tax Court becomes final an assessment can be made. In such an instance the correctness of the assessment which supports the tax lien has been judicially established. See Section 6215 of the 1954 Code (26 U.S.C. 1952 ed., Supp. II, Sec. 6215). With the exception of jeopardy assessments made pursuant to Section 6861 of the 1954 Code (26 U.S.C. 1952 ed., Supp. II, Sec. 6861) the only claims filed in a bankruptcy proceeding for unpaid income, estate or gift taxes which are not based upon a liability disclosed by the taxpayer to be due and owing, or upon an assessment for which the taxpayer had ample opportunity for a re-determination by the Tax Court, are assessments certified after the commencement of the bankruptcy proceeding pursuant to Section 6871 of the 1954 Code (26 U.S.C. 1952 ed., Supp. II, Sec. 6871), and there the Government does not claim lien status. Therefore, with the possible exception of a jeopardy assessment, which is not here involved, when a tax lien claim is presented for income, estate or gift taxes, the taxpayer has had ample opportunity for judicial review to determine the correct amount owing, and the tax lien reflects more than a mere assertion of liability.

Further, as already set forth, in the case of taxes not subject to Tax Court jurisdiction there is often, as here, actually no controversy with respect to the amount of the assessment. But should there be controversy ample opportunity for judicial review is provided.

the disallowance of post-petition interest to the former and not to the latter. But even if there were a difference, we submit that it is immaterial on the issue as to whether the tax lien is entitled to obtain post-petition interest. As we have previously shown in Part C of our brief, prior to the Chandler Act the bankruptcy courts generally allowed post-petition interest on tax claims, both secured and unsecured, upon the ground that the intention of Congress required such payment. The Supreme Court in *Saper* held that this generally accepted rule was no longer applicable to unsecured tax claims in view of the Chandler Act amendments to Sections 57 and 64 of the Bankruptcy Act dealing with unsecured, including unsecured priority, claims. As we have shown, *supra,* the Supreme Court in *Saper* was not concerned with the interpretation of subsection b or c of Section 67. When in *Goggin* v. *California Labor Div., supra,* it was concerned with these subsections, the Supreme Court interpreted the intent of Congress (pp. 126-127) "to continue to safeguard interest under liens perfected before bankruptcy." We submit that one such interest to be safeguarded is the right to post-petition interest on a tax lien. Thus, in 4 Collier on Bankruptcy (14th ed., 1942), Section 67.24, p. 239, the following statement is made:

> Statutory liens for taxes and debts owing to the United States or any state or subdivision thereof "may be valid" as against the trustee by virtue of § 67b * * *. This provision probably represents little change in the law, since such liens were upheld under the Act of 1898, either because of

former § 67d or because such liens were not expressly invalidated.

Accordingly, as we have shown in Part C of our brief, *supra,* in order to arrive at a correct interpretation of the Congressional intent it is necessary to consider the amendments to Sections 57 and 64 in the light of subsections b and c of Section 67, and that when all these sections are read together they clearly show that Congress never intended to diminish the right of the United States to obtain payment in full on its tax lien, including post-petition interest, regardless of whether such tax lien is similar in all respects to a consensual lien.

5. We submit that there is no merit to the District Court's contention that to permit the imposition of post-petition interest is to impose a penalty, and that the latter is not allowable in bankruptcy. In the first place both the Internal Revenue Code of 1954 and the Bankruptcy Act distinguish between interest and penalties. The only pertinent provision in the Bankruptcy Act which disallows certain statutory penalties, Section 57j (11 U.S.C. 1952 ed., Sec. 93), does not apply to interest. In this connection it should be noted that one of the cases upon which the court below has relied (R. 32-33, 39) to support its disallowance of post-petition interest on the ground that such interest is in the nature of a penalty (*In re Burch,* 89 F. Supp. 249 (Kans.)) distinguishes between penalty and interest. In that case the District Court disallowed the penalty but allowed post-petition interest. See also *In re Parcham, supra.*[16] Even assuming that interest could

[16] The District Court also relies (R. 39-40) upon *In Re Union Fabrics,* 73 F. Supp. 685 (S.D. N.Y.), in which that court dis-

be likened to a penalty, to which we do not agree, it also appears that the court below has completely disregarded the decision of this Court in *In re Knox-Powell-Stockton Co.,* 100 F. 2d 979, in which this Court held that penalties were allowable if secured by a valid lien existing at the time of bankruptcy. See also *Commonwealth of Kentucky* v. *Farmers Bank & Trust Co.,* 139 F. 2d 226 (C.A. 6th); *Grimland* v. *United States,* 206 F. 2d 599 (C.A. 10th). As we shall discuss in greater detail, *infra,* this reason for disallowance of post-petition interest appears to rest upon supposed equitable grounds. It would appear that whatever equity would support the disallowance of post-petition interest would be at least, if not more, applicable to the disallowance of penalties. Nevertheless, as this Court appears to have recognized in *In re Knox-Powell-Stockton, supra,* the dignity of a valid tax lien requires the payment of tax penalties accrued by the lien regardless of any alleged equitable considerations.[17]

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allowed post-petition interest because the allowance thereof would (p. 688) "require the general creditors to pay the penalty caused by the delay necessitated to preserve and protect the estate." We submit that this case is not applicable here. In the first place the tax claims in that case were unsecured. Secondly, neither the decision of the Second Circuit in *Carter* v. *United States,* 168 F. 2d 272, nor the decision of the Supreme Court in *New York* v. *Saper,* 336 U.S. 328, which affirmed the decision of the District Court in *In re Union Fabrics,* nor the companion decision by the Second Circuit in *Saper* v. *New York,* 168 F. 2d 268, 271, held that post-petition interest should be treated as an unsecured penalty. Thus, this ground in *In re Union Fabrics* appears to be without force.

[17] Although in *In re Knox-Powell-Stockton, supra,* this Court was considering the effect of a statutory lien for delinquency penalties as recognized and preserved by Section 67d of the Bankruptcy Act prior to the enactment of the Chandler Act, the latter act did not purport to amend either Sections 60 or 67 of the Bankruptcy Act so as to invalidate statutory liens securing tax penalties. See *Goggin* v. *California Labor Div., supra,* pp. 126-127.

6. The last ground relied upon by the District Court to disallow post-petition interest is that it would not be equitable to unsecured creditors to allow the tax liens to be swollen by the inclusion of post-petition interest. This contention appears to be based upon what are conceived to be the equities appropriate for the benefit of the unsecured creditors in the distribution of the bankrupt estate.[18] But this is a matter of policy to be resolved by Congress, and not by the courts. Surely it is clear that Congress does not intend all creditors to be treated equally. Secured creditors have always received priority at the expense of unsecured creditors.

The District Court relies upon the following cases, among others, to support its decision (R. 34-36, 40-41; fns. 36, 38, 41): *Sampsell* v. *Imperial Paper Corp.,* 313 U.S. 215; *Ticonic Bank* v. *Sprague,* 303 U.S. 406; *Vanston Committee* v. *Green,* 329 U.S. 156; and *Gardner* v. *New Jersey,* 329 U.S. 565. We submit that none of these decisions support the decision below. *Sampsell* v. *Imperial Paper Corp., supra,* is not applicable here since it involves the question as to whether an unsecured creditor is entitled to a priority of distribution of his claim and does not involve either a secured creditor or post-petition interest. *Ticonic Bank* v. *Sprague, supra,* involves a liquidation of a national bank not under the Bankruptcy Act. Although in that case the Supreme Court did state that (p. 411) "It is in order to assure equality among creditors as of the date of insolvency that interest accruing thereafter

[18] In *New York* v. *Saper, supra,* the Supreme Court based its determination upon its interpretation of the effects of the amendments made by the Chandler Act and not upon any alleged equitable grounds.

is not considered.'', nevertheless the Supreme Court's opinion in that case appears to support the position of the United States in the present case and recognizes the distinction between unsecured and secured creditors (both consensual and statutory) with respect to the payment of interest as follows (pp. 411-413):

> The rule of *White* v. *Knox, supra,* does not require that interest be denied to the secured creditors unless the principle of equality of distribution is to be applied as between all creditors. Secured creditors have two sources of payment for their claims—the liability of the debtor and the liability of the pledged or mortgaged assets. One is personal, the other in rem. The liability in personam of the bank gives rise to a claim in rem against the free assets in the hands of the receiver; the claim in rem against the security continues as a claim in rem against that same security. With respect to the former the secured creditors have merely the same rights as any general creditor, and in so far as dividends are paid to secured creditors from free assets, they share ratably with the unsecured creditors, and their claims bear interest to the same date, that of insolvency. Compare *Merrill* v. *National Bank of Jacksonville,* 173 U.S. at 146; *Aldrich* v. *Chemical National Bank,* 176 U.S. 618, 638. But to the extent that one debt is secured and another is not there is manifestly an inequality of rights between the secured and unsecured creditors, which cannot be affected by the principle of equality of distribution (*American Iron & Steel Mfg. Co.* v. *Seaboard Air Line Ry., supra,* at 266; *Chemical National Bank* v. *Armstrong, supra,* at

376-377), and interest accruing after insolvency may not be withheld on account of that principle.

The rule as to the date to which interest is to be allowed on secured claims sharing pro rata with unsecured claims, cannot apply to the disposition of pledged or mortgaged assets subject to the lien of individual creditors, unless we are to disregard the rights in these assets prior to insolvency. But "liens, equities or rights arising . . . prior to insolvency and not in contemplation thereof, are not invalidated." *Scott* v. *Armstrong,* 146 U.S. 499, 510; *Merrill* v. *National Bank of Jacksonville,* 173 U.S. 131, 145. By contract *or, as in this case, by statute,* the secured creditors gain or are given a lien on or right in property "in addition to their claim against the estate of the bank." Section 11 (k) of the Federal Reserve Act as amended. *The statutory lien* prior to receivership withdrew the pledged security from the assets of the bank available to general creditors, in so far as might be necessary to satisfy the lien. Though title to the collateral was in the name of the bank, it was subject to this lien, and to that extent the property pledged could not properly be said to belong to the bank for purposes of distribution to creditors. *Scott* v. *Armstrong, supra* at 510.

As the obligation to pay interest is not destroyed by the insolvency and as the rights of the secured creditor in his collateral, contractual *or statutory,* are likewise unaffected, we are of the opinion that a secured creditor of a national bank in receivership may enforce his lien against his security, where it is sufficient to cover both principal and interest,

> until his claim for both is satisfied. [Emphasis supplied.]

Although *Vanston Committee* often has been cited for the proposition denying post-petition interest upon equitable considerations we submit that this is not an accurate application of the *Vanston* opinion. In *Vanston* the Supreme Court denied the recovery by a mortgagee of interest upon interest for the period following the commencement of bankruptcy. But, in *Vanston* the Supreme Court recognized (pp. 164-165) the exception involved here, i.e., the payment of post-petition interest to a secured creditor, and the payment of simple interest on the mortgage was allowed without contest (p. 159). Further, as we shall discuss, *infra*, there has not been any showing that the United States has caused such a delay in the bankruptcy administration so as to render the payment to it of post-petition interest an inequity with respect to other creditors. See also *Palo Alto Mutual Savings and Loan Ass'n.* v. *Williams,* 245 F. 2d 77, where this Court sitting *en banc* held that (p. 79) a study of the text of the *Vanston* opinion makes it clear that it did not overrule the principle that a secured creditor cannot be deprived of his interest in full to the date of the sale where the value of the security exceeds the debt and the interest thereon.[19]

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[19] It does not appear that the Supreme Court considered its *Vanston* opinion to require the denial of post-petition interest to a secured creditor, as is shown by its opinion in *Gardner* v. *New Jersey, supra,* which was decided approximately six weeks after *Vanston.* In the course of its opinion in *Gardner* the Supreme Court cited examples of questions of which the reorganization court might have jurisdiction, but decided none of them. One example listed was (p. 581) " * * * what interest, if any, accrues after the petition for reorganization has been filed, *Vanston Committee* v. *Green,*

In the present case the United States contends only that its security be treated no less favorably than other secured claims in bankruptcy. As already suggested, the rule stopping payment of interest on claims in bankruptcy is based on considerations of expediency and practical convenience, not present in the case of secured claims, including secured tax claims. No delay until final distribution is requisite in the case of a secured claim; it cannot be said in such cases that the delay is the law's and, therefore, interest should not be required. If the security is adequate to pay post-petition interest as well as principal, it can at once be utilized and no more or different time is necessary for that purpose after the petition is filed than before. Again, since the value of the security subject to the lien is not shared by other creditors, no recurring interest adjustments on claims, which might complicate administration, are involved.

In the case of insolvency both Congress and the courts have always favored the United States in collection of the public revenues which, by statutory mandate, includes interest to the date of payment. The obligation of a bankrupt's estate to pay taxes is of course distressing to an unsecured creditor who leaves the bankruptcy with empty hands, but Congress, who is aware of the plight of the unsecured creditor and the hardships worked on him by affording secured creditors, including the United States, prior payment, has since the earliest history of the United States always sought to protect the public revenue as well as to protect secured creditors.

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329 U.S. 156, are all questions for the reorganization court." Further support comes from the fact that in its later decision in *New York* v. *Saper,* the Supreme Court made no reference to *Vanston.*

One of the first acts of Congress under the then new Constitution, the Act of July 31, 1789, c. 5, 1 Stat. 29, Sec. 21, was passed in order to secure payment of the external duties by giving such revenue priority over the claims of other creditors of an insolvent. Congress has never seen fit since the beginning of the insolvency laws of the United States to reduce the tax obligation in the case of insolvency to equality with general unsecured claims. When it felt that a situation justified such action, the absolute right to payment in full of the tax obligation was modified, but never to the extent of protecting any but certain specified groups of creditors under very limited conditions, such as the priority given to administration cost and wage claims. In the present situation Congress has by statute included interest in the tax lien supported by the tax assessment and has provided that the tax lien shall be valid in bankruptcy proceeding. To now advance the argument that one portion of the lien (interest) is to be disallowed on the basis that it is not fair to unsecured creditors, and that Congress never intended to deplete the assets available for such other creditors, is to fly in the face of the basic intention of Congress evidenced by the history of legislation both in the insolvency and bankruptcy areas, to assure the revenues of the United States. It is also to discriminate against the security of the lien of the United States in favor of other secured creditors without any statutory warrant.

Whenever Congress has felt it was unjust to grant the tax obligation or any part of the tax obligation priority over general creditors it has amended the law to reflect that intention. But where Congress has ex-

pressly provided for the validity of the tax lien without any restriction as to any portion of the lien, we submit that it intended the entire lien, including interest, to subsist regardless of any alleged hardships worked on lower ranking creditors.[20] As already pointed out where Congress has intended any security to be subordinated in bankruptcy to any other claim that intention has been expressed specifically.

It is also asserted that a creditor whose security has originated in a contract will have extended something of value to his debtor and, accordingly, has more equity than the taxing agency which has made no addition in the estate of the debtor. When the latter seeks to recover interest on its tax claim, it is urged that the tax authority endeavors to obtain a return without having extended an economic benefit or taken an economic risk. But this argument applies equally to the principal of the tax claim and thus goes too far. In the last analysis the question is one of policy, and Congress has settled it by supporting the tax lien. After all, the protection and services which the United States affords surely were important in the creation of the bankrupt's estate. Congress having afforded the security recognition, there is no reason to suppose that it intended to deny it any of the incidents of a secured claim. Moreover, under the facts of the present case, this contention is totally without relevance. Here the taxes involved, such as withholding of employees' income and F.I.C.A. taxes, were in effect trust funds for the United States which the debtor collected from his employees and

[20] In any event there are no equitable rights to priorities of payment among unsecured creditors. These are based solely upon statute. 6 Remington on Bankruptcy (sixth ed.), Section 2778.

should have paid to the United States.[21] Instead, he used them in defraying his operating expense. Thus, it is readily apparent that the bankrupt estate may well have been increased by the amount of these taxes, and the bankrupt obtained an economic benefit from their receipt; surely he obtained an advantage over his competitors. There is a valid basis for the supposition that such funds, which normally should have been paid to the United States as taxes, were, in fact, paid to unsecured creditors.

CONCLUSION

The order of the District Court should be reversed and the secured claims of the United States in the amount of $2,453.64 for interest should be allowed in full.

Respectfully submitted,

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[21] It is also noted that with respect to the above taxes the United States is required to pay back to employees any overpayment of their income tax liability even though the taxpayer failed to pay to the United States the collected amounts.

Internal Revenue Code of 1954:

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any cost that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 1952 ed., Supp. II, Sec. 6321.)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C. 1952 ed., Supp. II, Sec. 6322.)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under state or territorial laws.*—In the office designated by the law of the State or Territory in which the property subject to the

lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With clerk of district court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) *With clerk of district court for District of Columbia.*—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(b) *Form of Notice.*—If the notice filed pursuant to subsection (a)(1) is in such form as would be valid if filed with the clerk of the United States district court pursuant to subsection (a)(2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

(c) *Exception in Case of Securities.*—

(1) *Exception.*—Even though notice of a lien provided in section 6321 has been filed in the manner prescribed in subsection (a) of this section, the lien shall not be valid with respect to a security, as defined in paragraph (2) of this subsection, as against any mortgagee, pledgee, or purchaser of such security, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien.

(2) *Definition of security.*—As used in this subsection, the term "security" means any bond, debenture, note or certificate or other evidence of indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

(d) *Disclosure of Amount of Outstanding Lien.*—If a notice of lien has been filed under subsection (a), the Secretary or his delegate is authorized to provide by rules or regulations the extent to which, and the conditions under which, information as to the amount of the outstanding obligation secured by the lien may be disclosed.

(26 U.S.C. 1952 ed., Supp. II, Sec. 6323.)

Bankruptcy Act, c. 541, 30 Stat. 544:

Sec. 64 [As amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840, and Sec. 19(a), Act of July 7, 1952, c. 579, 66 Stat. 420]. Debts Which Have Priority.—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; * * * (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, * * * (3) where the confirmation of an

arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, * * * the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further,* That in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States in [sic] entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

(11 U.S.C. 1952 ed., Sec. 104.)

Sec. 67 [As amended by Sec. 1, Act of June 22, 1938, *supra,* and Sec. 21(c) and (d), Act of July 7, 1952, *supra*]. Liens and Fraudulent Transfers.—a. * * *

b. The provisions of section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or to any State

or any subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

c. Where not enforced by sale before the filing of a petition initiating a proceeding under this Act, and except where the estate of the bankrupt is solvent: (1) though valid against the trustee under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or any subdivision thereof, on personal property not accompanied by possession of such property, and liens, whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act and such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act; and (2) the provisions of subsdivision b of this section to the contrary notwithstanding, statutory liens created or recognized by the laws of any State for debts owing to any person, including any State or any subdivision thereof, on personal property not accompanied by posession of, or by levy upon or by sequestration or distraint of, such property, shall not be

valid against the trustee: *Provided, however,* That so much of clause (1) of this subdivision c as restricts liens for wages and rent and clause (2) of this subdivision c shall not apply in proceedings under chapter X of this Act, unless an order shall be entered therein directing that bankruptcy be proceeded with, or in proceedings under section 77 of this Act. The court may on due notice order so much of any lien in excess of the restricted amount under clause (1) and any lien invalid under clause (2) of this subdivision c to be preserved for the benefit of the estate and, in any such event, such lien for the excess and such invalid lien, as the case may be, shall pass to the trustee.

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(11 U.S.C. 1952 ed., Sec. 107.)

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